Fiscal Note 2009 Biennium

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Bill #	SB0174	**Title:**	Revise laws on revenue administration
Primary Sponsor:	Elliott, Jim	**Status:**	As Amended in Senate Committee

- [ ] Significant Local Gov Impact
- [x] Needs to be included in HB 2
- [ ] Technical Concerns
- [ ] Included in the Executive Budget
- [ ] Significant Long-Term Impacts
- [ ] Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Expenditures:				
General Fund	$222,644	$211,224	$216,505	$221,917
Revenue:				
General Fund	$958,336	($2,884,292)	($2,969,445)	($3,058,111)
Net Impact-General Fund Balance:	$735,692	($3,095,516)	($3,185,950)	($3,280,028)

Description of fiscal impact: This bill decreases the late filing penalty which reduces revenues to the state general fund. This decrease is offset slightly through the discovery of underreported taxes, increased voluntary compliance with the tax laws, and increased penalties for underreporting.

FISCAL ANALYSIS

Assumptions:

1. Section one of this bill will amend 15-1-102, MCA, to add “disregarded entity as defined in 15-30-101” to the definition of a person.
2. Section two of this bill will amend 15-1-201, MCA, to state that the Department of Revenue *may* collect certain information from municipal corporations. The current law states that the Department of Revenue *shall* collect certain information from municipal corporations. The purpose of this change is to reduce unnecessary reporting by municipal corporations and still allow the collection of information that is necessary for the performance of the Department of Revenue’s statutory duties. This section of the bill would require other Montana state agencies to provide the Department of Revenue with relevant taxpayer information upon request, unless this is otherwise prohibited by law. This section of the bill would require

other Montana state agencies to provide confidential criminal justice information that may be evidence of fraud to appropriate Department of Revenue personnel, unless this is otherwise prohibited by law. This section would allow the Department of Revenue to exchange updated taxpayer name and address information with other state agencies, unless this is otherwise prohibited by law.

3. Section three of this bill will amend 15-1-216, MCA, (uniform penalty and interest) to reflect federal law. The late payment penalty for all taxes except trust taxes would be changed from 1.2% per month (12% maximum) to 0.5% per month (12% maximum). This penalty would not be imposed on an individual income taxpayer if the taxpayer pays at least 90% of the tax for the current year when due.
4. Section three subsection (2)(d)(i) will add a penalty for substantial understatement of individual income tax liability on the tax return. For subsection (2)(d)(i) substantial understatement of individual income tax liability is an amount higher than $2,500. New subsections (2)(d)(ii) through (2)(d)(iv) would add a penalty for substantial understatement of any tax or matter under 15-1-211(1)(a) other than individual income taxes, if the underpayment exceeds the lesser of 10% of the correct amount required on the return or $500,000. The penalty would be 20% of the underpayment, except in cases of fraud. The penalty for underpayment due to fraud, as defined in the IRS code, would be 75% of the underpayment.
5. Section three subsection (3) is amended to add "fraudulently" to persons who "purposely or knowingly" fail to file a return when due. The penalty for failure to file a return would be the greater of $1,000 or 15 percent a month, with a maximum of 75% of the tax liability. Under current law the penalty is not less than $1,000 and not more than $10,000.
6. Section three subsection (4)(a) will make it a felony for an individual to knowingly file, render, or sign a false or fraudulent return, or to supply false or fraudulent information with respect to return or report or investigation. The penalty upon conviction would be a fine of up to $20,000, imprisonment of up to 5 years, or both.
7. Section three subsection (4)(b) will make it a felony for a corporation, a partnership or other entity, an officer or employee of a corporation, a member or employee of a partnership or other entity to knowingly file, render, or sign a false or fraudulent return, or to supply false or fraudulent information with respect to return or report or investigation. The penalty upon conviction would be a fine of up to $50,000, imprisonment of up to 5 years, or both.
8. Section four of this bill would amend 15-30-112, MCA, (exemptions for the individual income tax) to make the definition of a qualifying child consistent with the IRS code.
9. Section five of this bill would amend 15-30-136, MCA, to limit the deduction for federal income taxes paid for estates and trusts to no more than $5,000. This is the same limit that individuals are allowed to deduct for the state individual income tax.
10. Section six of this bill would amend 15-30-144, MCA. Subsection (2) would be amended to allow an individual income taxpayer an automatic extension of up to 6 months after the filing date to file a return. The Department could allow a further extension with good cause. Under current law, a taxpayer is allowed an automatic extension of 4 months, and an additional automatic extension for 2 months.
11. Section seven of this bill would amend 15-30-149, MCA, to clarify the treatment of credits and refunds resulting from overpayment of individual income taxes.
12. Section eight of this bill would amend 15-30-301, MCA. New subsection (1)(d) would add "proceeds from real estate transactions that are required to be reported under rules or regulations of the United States department of the treasury" to the list of items that an information agent must report to the Department of Revenue when no withholding tax has been deducted.
13. Section nine of this bill would amend 15-30-303, MCA. New subsections (8)(a)(ii) and (8)(a)(iii) would require the Department of Revenue to furnish to the Department of Justice "all information necessary for the investigation and prevention of Medicaid fraud" and "all information necessary for investigation and prevention of crimes and fraud". New subsection (8)(i) would require the Department of Revenue to furnish to the Insurance Commissioner's Office "information necessary for the administration of Title 33, chapter 12" (insurer investments). New subsection (8)(j) would require the Department of Revenue to

furnish to the Office of Securities Commissioner "information necessary for the administration of Title 30, chapter 10" (securities regulation).

14. Section 10 of this bill would amend 15-31-511, MCA. Subsection (1) would make it unlawful to knowingly disclose or make known confidential corporation license tax information. Under current law, it is unlawful to disclose or make known confidential corporation license tax information, knowingly or unknowingly. New subsection (4)(c) would require the Department of Revenue to furnish to the Insurance Commissioner's Office "information necessary for the administration of Title 33, chapter 12" (insurer investments). New subsection (4)(d) would require the Department of Revenue to furnish to the Office of Securities Commissioner "information necessary for the administration of Title 30, chapter 10" (securities regulation).
15. Section 11 of this bill would amend 15-35-104, MCA, (reporting required for the coal severance tax) to eliminate the requirement that a coal mine operator must report the tons of coal sold to each purchaser for each quarter.
16. Section 12 of this bill would amend 15-36-313, MCA, (estimation of oil and gas production tax in the absence of a report) to eliminate the phrase "immediately after the time has expired". This is a routine cleanup of the language of the statute. The phrase has no substantive meaning.
17. Section 12 of this bill would amend 15-39-105, MCA, to make a reference to another statute consistent with changes in numbering resulting from another section of this bill.
18. Section 14 of this bill would amend 15-39-107, MCA, to make a reference to another statute consistent with changes in numbering resulting from another section of this bill.
19. Section 15 of this bill would amend 16-11-149, MCA, to move cigarette tax appeals from the State Tax Appeal Board to the Department of Revenue. A final ruling by the department may be appealed to the State Tax Appeal Board
20. Section 16 of this bill would amend 72-3-1006, MCA, to clarify the meaning of the statute.
21. Section 17 of this bill would make this bill effective on passage and approval.
22. Section 18 of this bill would make section 3(4) (false or fraudulent return penalties) applicable to returns or reports filed after June 30, 2007. Sections 2, 9 and 10 (sharing of information with other state agencies) would be applicable on the effective date (passage and approval). The remaining sections would be applicable to tax periods beginning after December 31, 2007.

IMPACT ON DEPARTMENT OF REVENUE EXPENDITURES:

23. The Department of Revenue would establish a tax fraud unit to administer the requirements of this bill. The tax fraud unit would consist of three FTE: one attorney, one paralegal, and one auditor. The unit would pursue criminal tax fraud and assist county attorneys in prosecuting the cases developed by the unit.

IMPACT ON REVENUE COLLECTIONS:

24. Reducing the late payment penalty from 1.2% per month to 0.5% per month would significantly reduce penalty and interest revenues. In the fiscal note for SB 514, the Department of Revenue has estimated that reducing the late payment penalty from 1.2% per month to 0.5% per month would decrease penalty and interest revenues by $4,125,000 in FY 2007. For purposes of this fiscal note this amount is assumed to increase at 3% per year.
25. Over the last five fiscal years penalty and interest collected from both individual income tax and corporate license tax has averaged $8.4 million dollars per fiscal year. For the purposes of this fiscal note it is assumed that 2% of the $8.4 million were the results of penalties for underreporting or $168,000 in underreporting penalties. Under proposed law penalties for underreporting increase by 200%. By increasing the penalties for underreporting income tax, revenue will increase by $336,000 in FY 2007. This amount is assumed to increase at 3% per year.
26. Requiring information agents to report additional information (section eight) is expected to help the Department of Revenue ensure that the proper amount of tax is withheld from non-resident sellers of

property for the capital gains from the sale of Montana property. This function complements the withholding process found in SB 220.

27. The other provisions of this bill would also increase future tax collections through the discovery of tax underpayments, and through increased voluntary compliance. If the bill becomes law, the Department of Revenue and other state agencies can start the information sharing process immediately. This bill would affect many of the taxes administered by the Department of Revenue. For purposes of this fiscal analysis, only the effect on individual income tax and corporation license and income tax collections will be considered. Even for these two taxes, it is difficult to accurately predict the increase in collections. However, with additional, conservative assumptions, an estimate of the impact on future revenues can be made. It is assumed that increased voluntary compliance and the discovery of tax underpayments will result in an increase of 0.1% (one tenth of a percent) increase in income tax collections. The collections will be made up of taxes from all open previous tax years, as well as the present tax year. The projected collections for the income taxes (individual and corporate) in HJR 2 are $922.597 million for FY 2006, $954.904 million for FY 2007, $958.336 million for FY 2008, and $1,018.378 million for FY 2009. Applying the three-year average increase from FY 2006 to FY 2009 increase to subsequent years results in projected collections of $1,050.305 million for FY 2010 and $1,082.232 million for FY2011. If this bill becomes law, the estimated increase in collections during FY 2008 would be $958,336 (0.001 x $958.336 million). The estimated increase in collections during FY 2009 would be $1,018,378 (0.001 x $1,018.378 million). The estimated increase in collections during FY 2010 would be $1,050,305 (0.001 x $1,050.305 million). The estimated increase in collections during FY 2011 would be $1,082,232 (0.001 x $1,082.232 million).
28. With the exceptions of sections 2, 9, and 10, this bill is effective for tax periods beginning after December 31, 2007. The revenue impacts from this bill due to increased discovery and compliance will start in FY 2008 and continue in later years. The other revenue impacts from increased underreporting penalties and reduced late reporting penalties are assumed to affect revenues in FY 2009 and later years.
29. The estimated revenue impacts are summarized in the table below.

SB 174 as Amended
Summary of Revenue Impacts

	FY 2008	FY 2009	FY 2010	FY 2011
Increased Income Tax Revenue due to Discovery and Increased Compliance	$958,336	$1,018,378	$1,050,305	$1,082,232
Increased Income Tax Revenue due to Increased Underreporting Penalty	$0	$346,080	$356,462	$367,156
Decreased Revenues due to Reduction of Late Reporting Penalty from 1.2% to 0.5%	$0	($4,248,750)	($4,376,213)	($4,507,499)
Net Impact to General Fund	**$958,336**	**($2,884,292)**	**($2,969,446)**	**($3,058,111)**

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Fiscal Impact:				
FTE	3.00	3.00	3.00	3.00
Expenditures:				
Personal Services	$196,718	$196,929	$201,852	$206,899
Operating Expenses	$14,151	$14,295	$14,652	$15,019
Equipment	$11,775	$0	$0	$0
TOTAL Expenditures	$222,644	$211,224	$216,505	$221,917
Funding of Expenditures:				
General Fund (01)	$222,644	$211,224	$216,505	$221,917
TOTAL Funding of Exp.	$222,644	$211,224	$216,505	$221,917
General Fund (01)	$958,336	($2,884,292)	($2,969,445)	($3,058,111)
TOTAL Revenues	$958,336	($2,884,292)	($2,969,445)	($3,058,111)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$735,692	($3,095,516)	($3,185,950)	($3,280,028)

Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*